

MEMORANDUM

TO: Mary Ann Borgeson, Chair, Douglas County Commissioner
Clare Duda, Vice-Chair, Douglas County Commissioner
Mike Boyle, Douglas County commissioner
Marc Kraft, Douglas County commissioner
PJ Morgan, Douglas County Commissioner
Chris Rodgers, Douglas County Commissioner
Pam Tusa, Douglas County Commissioner
Thomas Cavanaugh, Douglas County Clerk/Comptroller
Thomas Doyle, County Engineer
Kathleen Kelley, Chief Administrative Officer

CC: T. Paul Tomoser, Audit Committee Chair
Jack Armitage
Ron Bucher
Joni J. Davis
Eric Carlson, County Purchasing Agent
Jerry Leahy, Director of Public Property
Joe Lorenz, Director of Budget and Finance
Kathleen Hall, Chief Deputy Douglas County Clerk/Comptroller
Jerry Prazan, Finance Administrator Douglas County Clerk/Comptroller
Patrick Bloomingdale, Deputy County Administrator
Tom McDonald, Manager of Engineer Maintenance and Construction
Fred Weber, Hayes & Associates

FROM: Mike Dwornicki, Internal Audit Director

DATE: October 4, 2011

SUBJECT: Fixed Assets

Background

As part of the fiscal year audit plan, Douglas County Internal Audit performs internal control testing for the Douglas County external audit firm, Hayes and Associates, LLC. The external auditor uses the test data provided by Internal Audit to formulate a professional opinion about the County's year-end financial statements. Below are the details related to tests of the controls over fixed assets and construction-in-progress.

Objectives

The objectives of the audit were to determine that:

- Capital asset additions were properly authorized.
- Capital asset additions represented real assets owned by the County.
- All additions were recorded completely and accurately.
- Depreciation was recorded completely and accurately.
- Disposals were properly authorized.
- Disposals were recorded completely and accurately.

Scope and Methodology

The audit included a test of thirty additions to the Oracle Fixed Assets system. The items were chosen using both random and judgmental sampling methodologies. The sample included tests of items added to the system from the 2011 fiscal year. The assets included in the sample were tested to verify that:

- Purchase orders and requisitions were approved by the appropriate persons.
- Board approval, bidding, and quotes were obtained according to policy.
- The additions were added to the system in the correct period, account, and amount.
- The purchase orders and invoices for the additions matched each other and agreed with the information recorded in the fixed asset system.

Twenty asset retirements were chosen for testing. Ten items were chosen randomly from a list of fixed assets that were retired during the 2011 fiscal year. Ten other items were chosen judgmentally from a file containing Fixed Asset Status Reports and items transferred for the 2010 yearly auction. The auction was conducted after the close of the 2010 fiscal year. The items were tested to verify that:

- The retirements were properly recorded in the system including all related transactions.
- The retirement was properly authorized.

Twenty transactions from the 2011 fiscal year were randomly chosen from various Oracle expense accounts that included both asset purchases and repairs and maintenance. The items were reviewed to determine if the transactions were expensed or capitalized appropriately.

Ten pre-existing assets were reviewed to determine that both the current depreciation expense and the accumulated depreciation were properly calculated.

Five of nineteen 2011 fiscal year Engineering Department construction projects were judgmentally selected for testing. The tests included:

- Verification of Board approval of the project.
- Review of 80% of the 2011 fiscal year expenditures related to the five projects to ensure that the amounts were valid capital costs.
- Examination of evidence showing that the projects were related to valid County assets. Evidence included review of purchase agreements and GIS mapping that showed the assets were within County jurisdiction.

Three of six construction projects completed during the 2011 fiscal year were judgmentally selected for testing. Two were Engineering Office projects and the other was a Public Buildings project. The tests included:

- Verification that the assets were transferred to fixed assets in the correct account, period and amount.
- Recalculation of depreciation expense for accuracy.

Findings

Authorization of Expenditures and Accounting of Fixed Asset Transactions

Criteria: Fixed asset transactions, including related depreciation, should be properly reflected in the County's financial statements. All expenditures should be properly authorized.

Condition: There were a number of exceptions related to the individual transactions tested. The exceptions noted appear below:

- The trade-in and purchase of a skid loader was not recorded properly. The transaction did not take into account the trade-in gain of the older skid loader.
- Approximately \$28,000 of plumbing, electrical and other construction activity expended to make the Fitzgerald Boiler House usable as a garage facility was recorded as repairs and maintenance rather than a capitalized fixed asset.
- The assets included on a \$9,700 invoice for machinery and equipment related to the Boiler House project were not coded to the correct account and were not added to the fixed asset system according to accounting policy.
- The amount transferred to fixed assets at the completion of bridge project 1017 did not include \$2,600 for internal labor.
- One invoice tested included \$2,300 for training that had been inappropriately capitalized.

Effect: The effects of the above conditions are outlined below:

- The accounting basis of the new skid loader was overstated by \$6,700. Depreciation expense was overstated by \$700.
- The accounting treatment related to the modification of the Fitzgerald Boiler House understated fixed assets by approximately \$28,000 and incorrectly categorized and overstated expenses by approximately \$27,500.
- Machinery and equipment expense related to the \$9,700 invoice was incorrectly categorized and was not added to the fixed asset system.
- The capitalization of Project 1017 was understated by \$2600 while the related expense was incorrectly categorized and overstated by \$2,575.
- The incorrectly capitalized training overstated machinery and equipment by \$2,300 while the related expense was incorrectly categorized and understated by \$2,070.

Cause: The reasons for the above exceptions appear below:

- The fixed asset capitalization policy did not specifically define what types of expenditures to capitalize.
- The proper treatment of non-routine fixed asset transactions was not clearly communicated among all parties including personnel involved in coding and recording the transactions.

Recommendation: Proposals to improve the controls related to the above findings follow below:

- Enhance the capitalization policy to include more specific identification of which expenditures to capitalize and which to expense. Ensure the appropriate personnel are made aware and understand the application of policy changes. **Management Response:** Management concurs and will work with the County's Budget and Finance Director to formalize a more comprehensive capitalization policy and submit to the Board of Commissioners for approval.
- Accounting personnel should periodically meet with the Public Properties Department to discuss the nature of ongoing construction projects and the appropriate accounting treatment for the related expenditures. **Management Response:** The County Clerk's office and the Public Property Department concur with the recommendation for future reviews of capital construction, and all other construction projects. The Public Property Department intends to meet with the County Clerk's office to discuss all major Capitalization Projects.
- Consider using the Oracle Project module for all construction projects rather than only for the Engineering Office projects. **Management Response:** Management concurs; however, Public Properties is a County Board department and this office has no authority

to mandate they use Oracle Projects. If it is decided that Public Properties wishes to use the Projects application, we will be happy to assist in any way possible.

- Make the appropriate adjusting entries to correct the misstatements. **Management Response:** Management concurs and has made the appropriate adjusting entries.
- Add the expensed machinery and equipment to the fixed asset system. **Management Response:** Management concurs and has added the expensed machinery to the fixed asset system.

Purchasing Duties

Criteria: Purchasing duties should be adequately segregated so that one person does not have the ability to originate, approve and place a purchase order.

Condition: Authorization of the purchases tested led to a review of the requisition approval hierarchy. Purchasing personnel have the ability to place orders without generating requisitions. In some cases, the same purchasing personnel may also receive the purchased items.

Effect: Purchasing personnel have the ability to make purchases without the scrutiny of appropriate personnel. In some cases, purchasing personnel may have the ability to receive the purchased items providing further opportunity to convert assets to personal use and possibly avoid detection.

Cause: Purchasing Policy did not require Purchasing personnel to use requisitions when placing purchases within their own department.

Recommendation: Update Purchasing Department procedures to require a properly approved requisition for all purchases. **Management Response:** Purchasing has updated their internal policy to ensure a requisition to be written when utilizing “Purchasing budget funds”. The requisition will follow the hierarchy to be approved.

Internal Policies

Criteria: Fixed assets should be tracked to help ensure that their costs and conditions are properly reflected in the financial statements and to help ensure that the assets are properly utilized, maintained, and protected.

Condition: The testing of retirements and the transfers of completed projects to fixed assets revealed that internal policies and procedures were not always followed as outlined below:

- Six of ten retirements tested were recorded without a properly completed Fixed Asset Status Report form. It was noted that documentation of departmental authorization to dispose/retire the assets was provided but not on the form as required by internal policy.

- For the two completed Engineering projects tested, the Accounting Department could not provide clear evidence supporting the dates the expenditures were placed in service.

Effect: The effects of not following the internal policies appear below:

- Proper completion of the Fixed Asset Status Report form provides complete documentation of the final disposition of the assets including evidence of receipt upon transfer or final disposition. Without evidence of receipt management cannot be sure that transfers and disposals actually occurred as authorized. This presents greater exposure to the County for theft and loss of assets.
- Without appropriate documentation management cannot support the dates assets were placed in service which could lead to inaccurate reporting of the assets on the financial statements.

Cause: The reasons for the above exceptions appear below:

- The County did not have an effective procedure in place to enforce the use of the Fixed Asset Status Report form.
- The County did not have effective procedures in place that provided all the necessary documents supporting the dates constructed assets were placed in service.

Recommendation: Proposals to improve the controls related to the above findings follow:

- Reiterate to all the elected officials and appropriate departmental personnel the importance and proper use of the Fixed Asset Status Report form including the sign-offs of the receiving department. **Management Response:** This is already being done on a regular basis by Clerk/Comptroller and Purchasing employees.
- To help ensure that Accounting is notified when projects become available for public use, consider the notification of Accounting as a discreet event to include in the Engineer's project plans. **Management Response:** Engineering management plans to meet with the Clerk's office in early October to work out details for bridge project notification. Road segment notification has been in place.
- The Engineering Office should consider including percentage of completion along with the expenditure updates sent to Accounting so that all parties have a clear understanding of the status of construction projects. **Management Response:** Engineering Management will work with the Clerk's office to enhance the communication with accounting personnel to keep them informed of project status. Project completion percentage will be considered, but may not necessarily be the best way to keep them informed. There is not always a good correlation between project completion and the placed-in-service date.
- Accounting should include in its documentation, Engineering Office notification of project availability before transfer of construction projects to fixed assets can occur.

Management Response: Management concurs; and will work with the Engineer's office to assure proper notification is provided.

Audit Standards

Internal Audit conducted this audit in accordance with generally accepted government auditing standards. Those standards require that the audit is planned and performed to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. Internal Audit believes that the evidence obtained provides a reasonable basis for its findings and conclusions based on the audit objectives.

Internal Audit has reviewed this information with the Chief Deputy Douglas County Clerk, Director of Public Property, the County Purchasing Agent, and the Manager of Engineer Maintenance and Construction. Internal Audit appreciates the excellent cooperation provided by management and staff. Please provide your responses within two weeks of receiving this report. If you have any questions or wish to discuss the information presented in this report, please contact Mike Dwornicki at (402) 444-4327.